OCEAN DRILLING & EXPLORATION COMPANY
CHEVRON OIL COMPANY

IBLA 73-203 Decided July 15, 1975

Appeal from a decision of the Director, Geological Survey, denying requests for barging costs deductions on OCS leases OCS-0228, OCS-0229.

Reversed.

1. Contracts: Construction and Operation: Generally -- Oil and Gas Leases: Royalties -- Outer Continental Shelf Lands Act: Generally -- Outer Continental Shelf Lands Act: State Leases: Generally

In interpreting provisions of state leases which have been validated under section 6 of the Outer Continental Shelf Lands Act, 43 U.S.C. § 1335 (1970), the Department will give great weight to judicial and administrative interpretations rendered by officials of that State. Where, however, there is a conflict of opinion between state officials as to the proper interpretation of a provision of a state lease, the Department of the Interior will independently interpret that section, applying the general rules of contract construction.

2. Outer Continental Shelf Lands Act: State Leases: Generally

The provisions of those leases issued by the State of Louisiana on the 1948 lease form and which have been validated under section 6 of the Outer Continental Shelf

> Lands Act do not prohibit the allowance by the Oil and Gas Supervisor of a reasonable deduction of barging transportation costs from the field to the point of the first market for the production from the lease.

APPEARANCES: H. L. Rowe, Esq., El Dorado, Arkansas, for appellant, Ocean Drilling & Exploration Co.; G. Howard Dearing, Esq., for appellant, Chevron Oil Co.; David C. Branand, Esq., Office of the Solicitor, Washington, D.C., for the Bureau of Land Management and the United States Geological Survey.

OPINION BY ADMINISTRATIVE JUDGE HENRIQUES

Ocean Drilling & Exploration Company [Odeco] appeals from a decision of the Director, Geological Survey, dated October 27, 1972, refusing to permit deductions for transportation costs from the field to the first market for section 6 OCS lease OCS-0229.

On November 19, 1948, the Louisiana State Mineral Board issued State Lease No. 1662 to Phillips Petroleum for the lands involved in this appeal. Pursuant to the provisions of section 6 of the Outer Continental Shelf Lands Act, [OCSLA] Act of August 7, 1953, 67 Stat. 465, 43 U.S.C. § 1335 (1970), the Acting Director, Bureau of Land Management, gave notice on September 30, 1954, that State Lease No. 1662 was deemed to meet the requirements of the OCSLA and would be continued thereunder. The Acting Director designated the lease OCS-0229. By instrument dated March 4, 1959, and approved effective May 1, 1959, Phillips Petroleum assigned its interest in the subject lease to the appellant. Appellant subsequently assigned a 54% interest to Midwest Oil Company.

On January 27, 1961, the Oil and Gas Supervisor, Gulf Coast Region, Geological Survey, returned as unacceptable a tendered royalty payment from Odeco which had deducted as transportation costs the cost of barging the oil from the point of production to the first market.

Odeco thereupon submitted a second check in the amount of $531.80 in payment of the previously deducted barging costs and appealed the Oil and Gas Supervisor's decision.

Chevron Oil Company appeals the same decision of the Director, Geological Survey, to the extent that it refused to permit deductions for transportation costs from the field to the first market for section 6 OCS lease OCS-0228.

Chevron Oil Company's predecessor in interest, The California Company, had requested permission to subtract its barging costs for the production from Lease OCS-0228 to an onshore terminus before the computation of royalty owing to the Government. By letter dated August 30, 1960, the Oil and Gas Supervisor, Gulf Coast Region, Geological Survey, denied this request. Appellant thereupon appealed to the Director, Geological Survey.

By decision dated October 27, 1972, the Director, Geological Survey, affirmed the actions of the Oil and Gas Supervisor in denying such deductions in a number of cases, including the two leases which are the subject of the appeal before us. Timely appeal to this Board was then made.

While the decision of the Director, Geological Survey, encompassed leases issued by the State of Louisiana on both the February 1942 form and the October 1948 form, the leases involved herein were both issued on the 1948 form.

The Director noted that the 1942 form provided that in computing the value of production on the premises "no deductions or charges shall be made for gathering or transporting said oil to the purchaser thereof, or loading terminal, nor shall any deductions whatsoever be made chargeable to the lessor" (Dec. 5). The 1948 form, in contrast to the explicit prohibition of the 1942 form, provided in § 6, that:

> Lessee shall deliver to Lessor as royalty, free of cost of production: One-eighth (1/8) of all oil, including distillate and other liquid hydro-carbons, produced and saved at the well by ordinary production methods, delivery to be understood as made when same has been received by the first purchaser thereof. Or Lessee may, in lieu of said delivery and at Lessee's option, pay the Lessor sums equal to the value thereof on the premises. The price paid Lessor shall not be less than the average posted pipeline price in the same field or loading terminal price in the same field then current for oil, including distillate or other liquid hydro-carbons, of like grade or quality. (Emphasis supplied).

The Director in denying barging cost deductions noted that while such costs were an allowable deduction under section 8 leases, that is leases issued under the aegis of OCSLA, the rights of section 6 leases, (leases issued originally by the states but subsequently validated by the Secretary of the Interior pursuant to section 6 of OCSLA) were circumscribed in the matter of royalties by the terms of the lease. See 30 CFR 250.100(a).

The Director adverted to a resolution adopted by the Louisiana State Mineral Board on May 13, 1965, which established standards under which the deductibility of transportation costs could be determined. The standard provided that:

> (a) Under the 1940 and 1942 lease forms, no transportation costs should be deducted.
>
> (b) Under the 1928, 1930, 1936, 1948, and 1962 lease forms, deductions for transportation costs may be allowed if the facts of any particular case as shown to the Louisiana State Mineral Board disclose that such costs are extraordinary in nature and are necessary to obtain a market for the production in question.

The Director argued, with some persuasiveness, that:

> [a]lthough the United States is not bound by such State policies or interpretations, it would seem unusual, and inconsistent with the intent of section 6 of the OCS Act, for the holder of a State lease to gain an advantage over the holders of other State leases in paying royalties solely because he had been accorded the privilege of validation under section 6. (Dec. 7).

Finally the Director concluded that neither appellant had shown how its transportation costs incurred in marketing the oil were "extraordinary."

[1] Were this case presented to us in the simple posture of a definitive ruling by a court of the State of Louisiana as to the unavailability of a transportation deduction under the provisions of § 6 of the 1948 lease form utilized by the State of Louisiana, we would agree with the decision reached by the Director. The policy considerations relating to the equal treatment of lessees to which the Director referred are sound principles with which we must be concerned. The difficulty, however, is that the permissibility of transportation deductions under § 6 of the 1948 lease form has not been adjudicated by any court of competent jurisdiction within the State of Louisiana and the administrative pronouncements thereon are both conflicting and obscure.

First of all, the Office of the Attorney General of the State of Louisiana has, on four separate occasions, held that such transportation costs are deductible under the provisions of the 1948 lease form. Thus, by letter dated May 20, 1955, to an attorney with the State Mineral Board, the First Assistant Attorney General held that, in reference to a lease issued on the 1948 form, "the transportation costs referred to are legally deductible from the state's portion of the price of the sale of the oil, distillate or other liquid hydrocarbons produced under the lease." This belief was reaffirmed in opinions rendered on September 13, 1955, on May 8, 1958, and on December 16, 1968.

This Board in the past has followed the interpretation of state law advanced by the State Attorney General in the absence of any contrary state court decisions. See Beverly Harrell, 13 IBLA 276 (1973). The State Mineral Board, however, is also an agency of the state, see Louisiana Land & Exploration Co. v. State Mineral Bd., 229 F.2d 5 (5th Cir. 1956), and is the body authorized to lease "any lands belonging to the state, or the title to which is in the public, including road beds, water bottoms, and land adjudicated to the state at tax sale." LSA-R.S. 30:124. The State Mineral Board also has complete supervision of oil and gas leases on state public lands. LSA-R.S. 30:129. The Register of the State Land Office receives all bonuses, rentals and royalties due from state leases, subject to the review and approval by the State Mineral Board. LSA-R.S. 30:131. Thus, the opinion of the State Mineral Board is one which cannot be lightly set aside.

The Director, Geological Survey, relied on standards established by the State Mineral Board on May 13, 1965, in denying the requested deductions. But the State Mineral Board, had, on an earlier occasion, issued an opinion at variance with the May 13 order. In a resolution unanimously adopted on July 16, 1959, the State Mineral Board declared that "no deduction be made under any State lease [past or present] for a portion or proportionate part of transporting, storing or barging, or otherwise disposing of or delivering oil, gas and other minerals produced under the lease in calculating the paying royalties to the State." Thus, in 1959 the State Mineral Board saw no difference between the 1940 and 1942 lease forms and the 1928, 1930, 1936, and 1948 lease forms and made no reference to costs of an "extraordinary nature" being deductible.

We can perceive no consistent way of rationalizing these divergent views. Yet, at the same time it is necessary in the administration of the section 6 leases that a rule be adopted that does not depend on the varying views of conflicting state entities. Therefore, we have no choice but to rely on our own analysis of the lease terms to establish the permissibility of deductions sought in the instant case.

This Board has often held that oil and gas lease agreements are subject to the same rules of construction as are contracts between private parties. See Marathon Oil Co., 16 IBLA 298, 306, 81 I.D. 447, 450 (1974); Superior Oil Co., 12 IBLA 212 (1973); Amoco Production Co., 10 IBLA 215 (1973). See also Reading Steel Casing Co. v. United States, 268 U.S. 186, 188 (1925). Similarly, words are construed in their ordinary meaning, unless it is shown that the parties intended otherwise. International Erectors, Inc. v. Wilhoit Steel Erectors and Rental Service, 400 F.2d 465, 468 (5th Cir., 1968); Jamesbury Corp. v. Worcester Valve Co., 443 F.2d 205, 210 (1st Cir. 1971).

[2] Unlike the 1942 lease form which specifically prohibited deductions for transportation costs, the 1948 lease form merely declared that the royalty would be delivered "free of cost of production." Transportation costs are not considered to be cost of production. See e.g., Shell Oil Co., 70 I.D. 393 (1963); The California Co., 66 I.D. 54 (1959) aff'd 296 F.2d 384 (D.C. Cir. 1961); The Texas Co., 64 I.D. 76 (1957).

In Shell Oil Co., supra, the Acting Solicitor held that barging costs are a relevant matter to be taken into account in computing the royalties due the United States where there is no bona fide established market at the field or area where the leases are situated. We concur in that holding and find nothing in the language of section 6 of the 1948 lease form that prevents such a deduction. Accordingly, we reverse the decision of the Director, Geological Survey, that such a deduction is not permitted under section 6 of the 1948 lease form. This is not to say that the allowance of a deduction for barging costs is mandatory. The deduction may be allowed only upon a satisfactory showing that the cost was necessary to reach the nearest available market, and that the selling price did not include an additional charge for recovery of the producer's transportation costs. See Superior Oil Co., 12 IBLA 212, 227, 228 (1973). The Secretary's discretion to determine the method of establishing an allowance for transportation costs (described in Shell Oil Co., supra) is operative as to State leases such as this.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is reversed and the case files are remanded for appropriate action not inconsistent with this opinion.

Douglas E. Henriques
Administrative Judge

We concur:

Edward W. Stuebing
Administrative Judge

Frederick Fishman
Administrative Judge